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TECH & DATA

Special Purpose Acquisition Companies

Keeping up with the latest Wall Street Craze

26 April 2021

- US SPACs had a record year in 2020 with $83bn of issuance. In 2021, the trend is accelerating further with another $99bn raised in the space of 4 months
- In this note, we take a close look at their main mechanisms and recent performance.
- Is the euphoria sustainable and can it spread to Europe?

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Special Purpose Acquisition Companies (SPACs) are not new. Their origins were traced to 18th century England and the use of "blind pools" during the infamous South Sea Bubble (Y. Shachmurove & M. Vulanovic, Sep 2018). Blank check companies also thrived in America in the 1980's but were often associated with fraudulent schemes, unscrupulous promoters and failing businesses until the Penny Stock Reform Act of 1990 and the SEC 419-a rule of 1992 put an end to their proliferation. Modern SPAC structures were subsequently designed to work around those regulations, obtaining exemptions in exchange for a higher level of investor protection: in 1993, investment banker David Nussbaum and lawyer David Miller set-up the Information Systems Acquisition Corp, raised 12 million dollars and merged with a private software company, marking the beginning of a long series of similar transactions. Still, SPAC adoption wasn't an overnight success. Traditional IPOs continued to be the preferred route to public listings and it took more than 25 years for the craze to ignite fully.

Covid19-induced volatility forced many private companies to start looking for new ways of attracting capital as VC funding became more difficult to secure. This, combined with the emergence of well-documented democratisation trends in financial markets, the willingness of young entrepreneurs to disrupt established practices and a strong appetite for growth stories, pushed US SPAC issuance to $83bn in 2020, a 6-time increase on the previous year and roughly 50% of the total US IPO market over the period. Despite the roll out of vaccination campaigns and a return to some form of economic stability, volumes accelerated further in 2021 with another $99bn raised in the space of 4 months.

Although fraud cases were never completely eradicated from SPAC offerings (Luxembourg-domiciled music streaming business Akazoo was sued for securities fraud by the SEC in 2020 and electric vehicle manufacturer Nikola was accused of misleading investors during its merger process), their reputation improved markedly with popular celebrities such as Shaquille O'Neal, Alex Rodriguez or Colin Kaepernick joining teams of seasoned professionals and, for good or ill, raising the public profile of these strategies. According to SPAC Insider, 435 SPACs are now looking for acquisitions with a total firepower of $150bn. Reportedly, another 150 are in the process of registering for an IPO, their popularity seemingly reaching new highs on a daily basis.

Is the euphoria sustainable and can it spread to other regions?

In this note, we analyse the recent success of those vehicles and show their appeal for a new generation of entrepreneurs intent on exploiting the very positive post-pandemic market momentum before it's too late. We describe the main SPAC mechanisms and show how major conflicts of interest arise from misaligned incentives between the various classes of investors. We take a look at recent post-merger SPAC performance and conclude that, despite a few successes, the high level of dilution resulting from standard SPAC structures is rarely compensated by natural value creation after the deal. Finally, if Europe is warming up to the concept, investors will be expecting a better deal and it will be necessary to rethink the product – perhaps alongside the lines of what Bill Ackman proposed in a recent offering.

Enjoy the read!

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Content

How do SPACs work?

A Special Purpose Acquisition Company, or SPAC, is a shell company set-up by investors with the sole purpose of raising cash through an IPO in order to complete an M&A transaction. Such transaction must take place within two years, otherwise the SPAC is liquidated and funds are returned to shareholders.

The SPAC founders, referred to as the Sponsors, are a group of experienced finance and business professionals, often with a long and solid investment track record and a deep knowledge and understanding of the sectors in which they choose to operate. Together, they constitute the SPAC's main source of credibility and determine the strategy of the vehicle. They typically target companies in a specific industry (electric vehicles, batteries, renewable energies, vertical farming, cloud computing etc…) and are able to attract funding based on their perceived ability to identify quality targets and negotiate a value-creating merger before the 2-year deadline expires.

In theory, however, anyone can start a SPAC and in recent developments, several high profile American celebrities have lent their name to various SPAC initiatives: from Serena Williams, to Shaquille O'Neal, Alex Rodriguez or Billy Beane, many popular A-listers have seemingly decided to reinvent themselves as new representatives of the Wall Street elite. This has of course attracted a lot of scepticism from the press and traditional financial circles. In a March 2021 alert, the SEC even warned against the phenomenon, writing that it was "never a good idea to invest in a SPAC just because someone famous sponsors or invests in it or says it is a good investment". Quite right. But, presumably, in a world where a new SPAC is born almost every day, having the support of a popular athlete, an astronaut or a Nobel Prize can also give you the tiny bit of extra visibility that is needed to conclude a desirable transaction.

Sponsors generally contribute 2% to 5% of a SPAC's total fundraising. The money is lost when the company fails to merge with a target and goes into liquidation. It is otherwise used to cover IPO costs and working capital requirements during the search phase. In exchange for that initial commitment, sponsors are allowed to purchase Class B shares for a small nominal price (often around $25,000), giving them access, after a successful merger, to 20% of the total share outstanding post IPO. This incentive is known as the "promote".

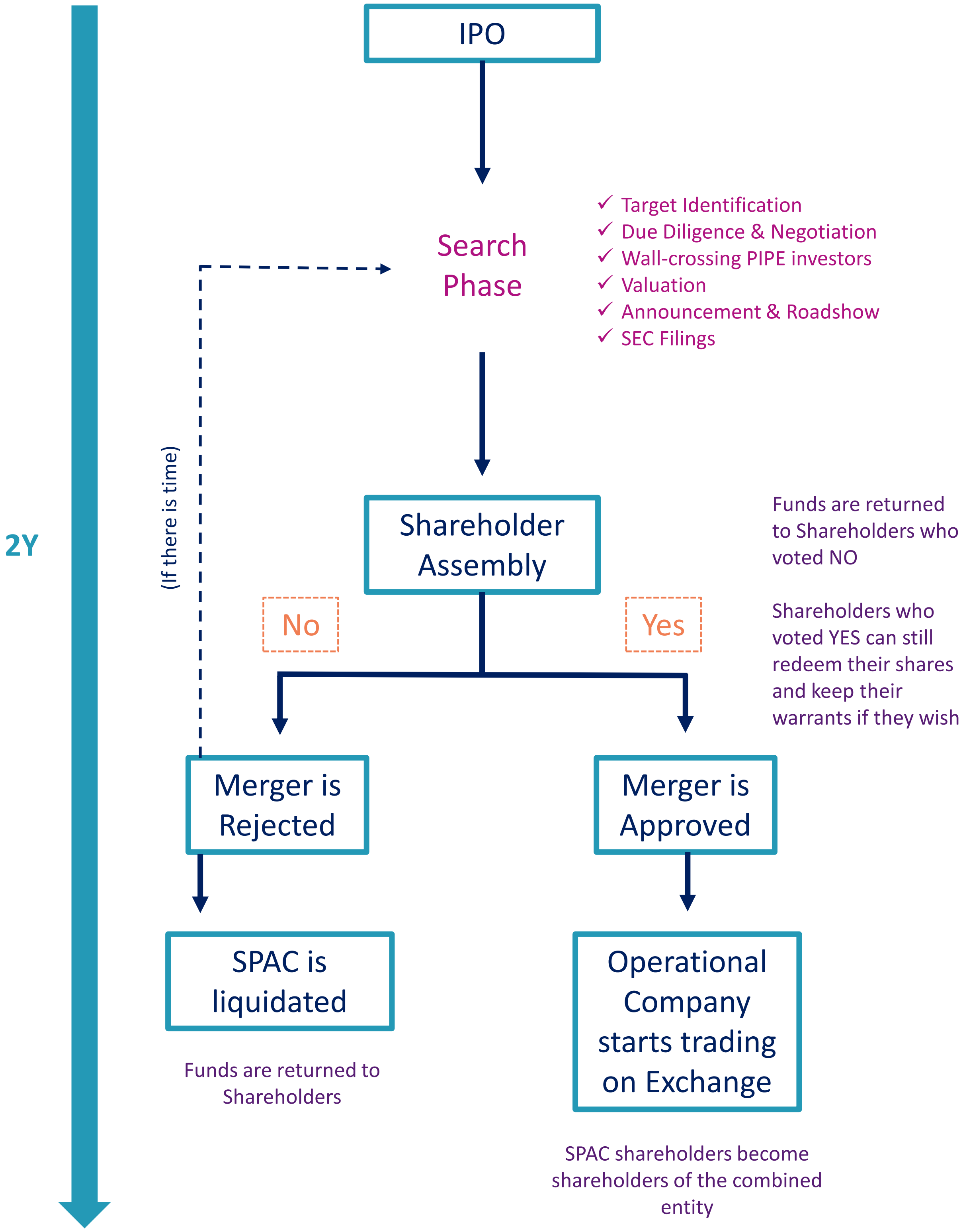
Public investors in the IPO are offered units at $10 (€10 in Europe), comprised of one Class A share and a warrant equal to a fraction of a Class A share. Class A shares eventually become fungible into common shares of the new post-combination public company. The warrants generally have a strike price of $11.5 (€11.5 in Europe) and become exercisable a minimum of 30 days after the merger and for a period of 5 years. They can also be recalled by the company once the stock has been trading above $18 (€18) for a predefined number of days. Class A shares and warrants normally start trading separately on a national exchange soon after the IPO. Proceeds from the IPO are deposited on an escrow account and can only be used to fund the approved de-SPAC transaction. The funds naturally attract interest during that period.

Holders of Class A shares are entitled to vote in favour or against the proposed merger. Crucially, they may also decide to redeem their shares at par (plus accrued interest) whilst retaining their warrants, irrespective of how they choose to vote at the shareholder assembly. The de-SPAC transaction generally needs to be approved by a qualified majority of between 50% and 70%.

SPACs are designed to be very flexible structures. Although, on average, they are looking to raise $250-300mn through their IPO, they often approach larger targets and it is not uncommon for them to seek business with companies that are 2x to 4x times bigger in EV terms. This is primarily a way to limit the dilution effect attached to the allocation of Class B shares and warrants. This means, however, that additional funding may be needed closer to the merger in order to reach a successful outcome.

Early Class A shares' redemptions also amplify those late funding requirements and create a rush for fresh capital in the form of debt or PIPE injections (Private Investment in Public Equity). Private investors participating in those funding rounds are typically offered a chunk of the SPAC's public securities at a generous discount.

Life Cycle of a standard SPAC Structure

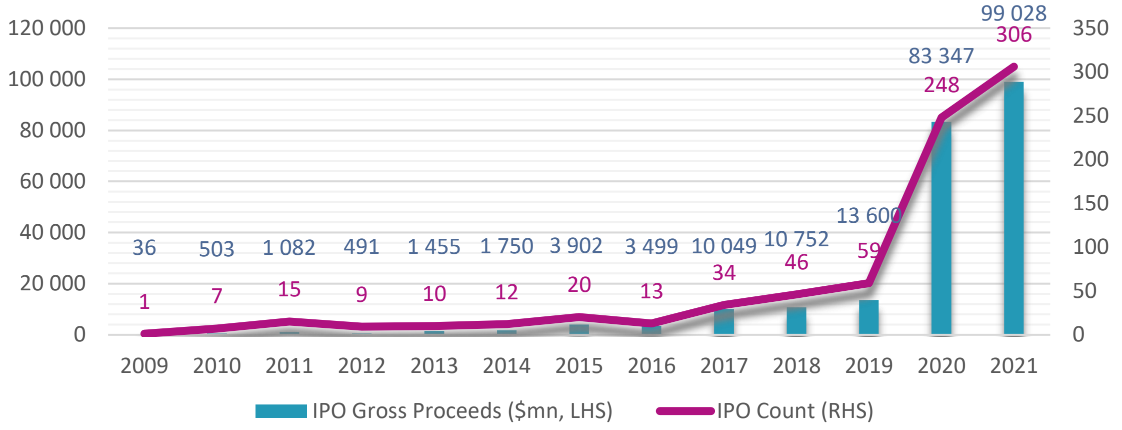


Source: Natixis

Why the very recent success?

While SPACs have been around for almost 3 decades, it is only in 2020 that they have started to make a name for themselves, when they took 50% of the total amount raised on the US IPO market.

US SPACs IPO Gross Proceeds ($mn) and deal count since 2009



Source: Spac Insider, April 13th 2021

From $13.6bn in 2019, volumes grew 6x to $83.3bn in the space of 12 months and accelerated further in 2021 with nearly $100bn of issuance after 4 months.

Observers report that a certain willingness on the part of entrepreneurs to disrupt established practices and democratise financial markets has played into the hands of SPAC promoters: on paper, they are indeed allowing dozens of companies to enter public markets early so that they don't have to continue courting private investment funds for years. In a way, after the opening of equity markets to "Robinhooders" through zero-com brokerage, it is now the world of Private Equity that is seemingly coming to the street.

This may be true to an extent, but it is hard to ignore, first and foremost, the impact of ultra-accommodative central bank policies and multi-trillion-dollar post-pandemic recovery plans on global capital flows. On the one hand, excess cash is increasingly pouring into high-growth propositions, pushing the Nasdaq and the tech sector to record levels. On the other hand, the sanitary crisis has sometimes made it more difficult to attract VC money and left many young companies with few other options but to take the SPAC route in order to continue fuelling their growth trajectory.

In truth, SPACs have primarily gained in popularity because they appeal to start-up businesses that are keen to exploit a very positive post-Covid 19 market momentum before it is too late.

A faster and lighter route to public listings?

It has often been said that SPACs provide a much faster and lighter way to a public listing than a traditional IPO.

Again, in our view, this is only true to an extent: in the US, a standard IPO may take 5 to 6 months to come to fruition (assuming supportive market conditions) while the SPAC process may be shorter by a couple of months only. The SPAC route doesn't eliminate the need for a roadshow and claims that the necessary documentation is reduced to a minimum are inaccurate. Target companies still have to file with the SEC and comply with a very strict legal framework:

"Any material misstatement in or omission from an effective Securities Act registration statement as part of a de-SPAC business combination is subject to Securities Act Section 11. Equally clear is that any material misstatement or omission in connection with a proxy solicitation is subject to liability under Exchange Act Section 14(a) and Rule 14a-9, under which courts and the Commission have generally applied a "negligence" standard. Any material misstatement or omission in connection with a tender offer is subject to liability under Exchange Act Section 14(e). De-SPAC transactions also may give rise to liability under state law. Delaware corporate law, in particular, conventionally applies both a duty of candour and fiduciary duties more strictly in conflict of interest settings, absent special procedural steps, which themselves may be a source of liability risk. ***Given this legal landscape, SPAC sponsors and targets should already be hearing from their legal, accounting, and financial advisors that a de-SPAC transaction gives no one a free pass for material misstatements or omissions".***

(Source: SEC, John Coates, Acting Director, Division of Corporation Finance, SPACs, IPOs and Liability Risk under the Securities Laws, April 8th, 2021)

The fact that de-SPAC merger transactions are somewhat benefiting from the Private Securities Reform Act (PSLRA) safe harbour on forward-looking statements is perhaps helping reduce the time spent with lawyers on protecting against potential liabilities linked to financial projections. However, we expect the SEC to close that loophole soon and start treating de-SPAC listings in a similar way to IPOs:

"The PSLRA safe harbour should not be available for any unknown private company introducing itself to the public markets*. Such a conclusion should hold regardless of what structure or method it used to do so. The reason is simple: the public knows nothing about this private company. Appropriate liability should attach to whatever claims it is making, or others are making on its behalf*

(Source: SEC, John Coates, Acting Director, Division of Corporation Finance, SPACs, IPOs and Liability Risk under the Securities Laws, April 8th, 2021)

This will inevitably result in more thorough Due Diligence processes, higher legal fees, more balanced projections with a clearer analysis of adverse business scenarii and therefore longer times to market for the SPAC target.

A fairer valuation and a cheaper deal for target companies?

Sellers often worry that banks under-price IPO shares to transfer value to their preferred customers. According to Nasdaq Chief Economist Phil Mackintosh, the average "IPO Pop" on US exchanges in 2020 was 38% (18.4% between 1980 and 2020), which many entrepreneurs see as money "left on the table". In a traditional IPO set-up, they have little control over the price discovery process: feedback is obtained after multiple opaque pricing iterations between the book-runners and their most trusted clients. Instead, SPACs provide a "straightforward" and more transparent negotiation between the sponsors, the seller and a small number of PIPE investors taken over the wall. This normally results in a more favourable valuation outcome for the target's shareholders.

The typical underwriting fee for a SPAC is also slightly lower than that of a classic IPO and generally represents 5.5% of the proceeds, with 2% paid upfront by the sponsors and 3.5% supported by the SPAC shareholders at the time of the merger. This compares with 7% for standard size US IPOs.

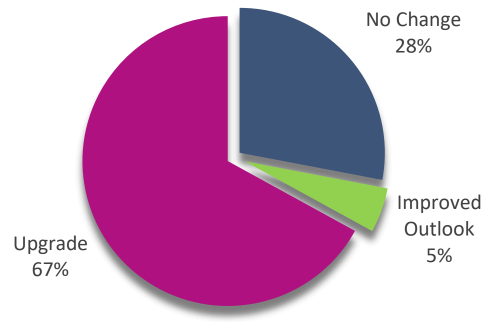
At first sight, SPACs do seem to propose a fairer and cheaper deal to the sellers. However, and as discussed later in the note, intrinsic SPAC dilution effects represent a significant source of indirect costs that should never be ignored.

A credit enhancing strategy?

According to Research published by Moody's on April the 7th 2021, corporate issuers "generally emerge with stronger credit quality" after a merger with a SPAC. The rating agency analysed over 30 issuers in their coverage universe that were involved in a de-SPAC transaction and found that, on average, they had lower debt and improved liquidity after the deal.

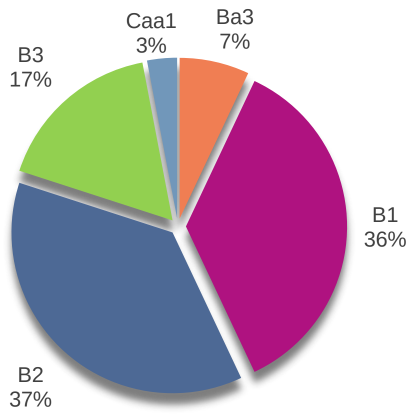
They also noted that first time ratings for de-SPAC transactions fared better than those assigned to the general speculative-grade population

SPAC acquisition resulted in mostly positive rating actions for existing issuers

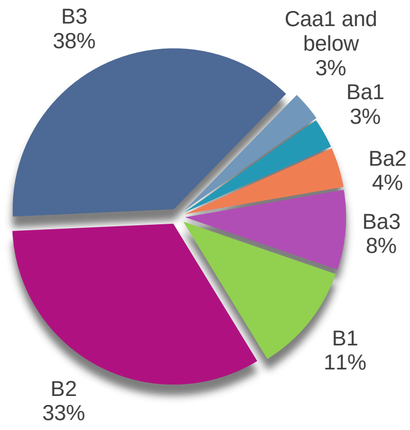


Source: Moody's Investors Services, Sector In-Depth, April 7th, 2021

Initial de-SPACs rating assignment since 2017



First time ratings for all speculative-grade issuers since 2017



Source: Moody's Investors Services, Sector In-Depth, April 7th, 2021

As a result, SPAC mergers may also appeal to target companies that are looking to strengthen their balance sheet. For example, Hillman's Corporate Family Rating was upgraded by Moody's from B3 to B1 in February after the announcement of its merger with Landcadia and the deal between WeWork and BowX Acquisition may eventually reverse a series of painful credit downgrades for the shared office provider. Unfortunately, success is never guaranteed as any positive credit outcome largely depends on the sponsor's ability to replace redeeming shareholders with fresh capital from PIPE investors. Failure to do so can instead result in more debt at SPAC's level and a potential deterioration of the credit worthiness of the target after the merger.

We're also concerned that the ongoing trend for much larger SPAC acquisitions will result in a more significant use of debt financing going forward.

An appealing structure for Sponsors and Hedge Funds

As mentioned earlier, the success of SPACs essentially lies in the interest from target companies with regards to speed to market, valuation, transaction costs and credit worthiness. But it takes two to tango, and the structure also naturally appeals to sponsors and their hedge fund partners.

Sponsors contribute 2-5% of the SPAC's fundraising in exchange for which, they acquire – for a small upfront fee - Class B shares giving them access to 20% of the SPAC's pro-forma capital (the "promote"). They stand to lose their initial commitment if no merger is consumed within 2 years but are otherwise likely to benefit greatly from their investment, even if the shares of the combined entity underperform.

It is not uncommon to see Sponsors having to renegotiate their promote with PIPE investors in order to agree a deal and most of the time they are subject to lockup rules that prohibit them from selling their shares for 1 year after the business combination (these rules are occasionally released when the stocks trade above a specified threshold for a predefined number of days, e.g. > $12 for 20 out of 30 trading days beginning 150 days after closing). Even so, Klausner, Ohlrogee and Ruan determine in a Sober Look at SPACs (April 2021), that the return on investment for SPAC Sponsors between January 2019 and June 2020 has reached a compelling mean of 393% after 3 months and 187% after 1 year, despite a very high post-merger spot dispersion between deals.

For Hedge Funds, SPACs also provide attractive sources of revenue. As investors in the IPO, they receive units comprised of a redeemable Class A share and a warrant equivalent to a fraction of a Class A share (1/2, 1/3 or 1/4 in most case). Many see their investment as a risk-free cash management strategy, where they attract treasury yields during the search phase and can redeem their shares at par before the merger, whilst voting in favour of the deal and selling their warrants at market value. The Klausner, Ohlrogee and Ruan study attributes an average 11.6% return to this strategy – an attractive performance given the actual risks involved.

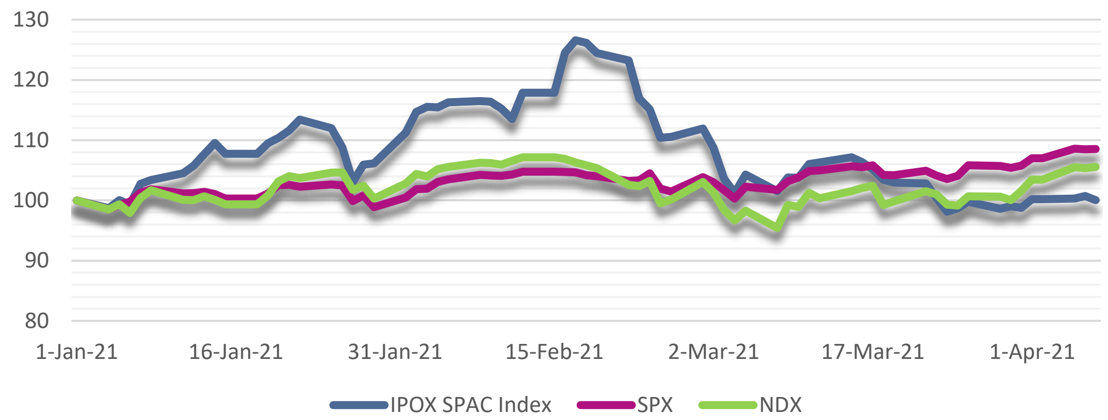
Those warrants, which they essentially receive for free as an incentive to deposit funds on an escrow account for a maximum period of 2 years, can also be arbed after the merger. Indeed, de-SPAC entities are very volatile and can lead to significant profits for experienced traders. It is quite amusing to regularly see pre-merger estimates of the theoretical value of those warrants obtained through a simple Black & Scholes model and an arbitrary 20% implied volatility. A quick calculation of the last average 3-month realised volatility of the post-combination entities listed in 2020 yields a result closer to 80%!

Is the SPAC euphoria sustainable?

We don't think so. Not in its current form at least..

Of course, the now reduced investor appetite for "growth" companies on the back of increasing long-term interest rates constitutes a significant headwind for the SPAC industry and the average pre-merger SPAC performance has been abysmal in March as evidenced by the IPOX SPAC index. However, the ongoing sector rotation in favour of the "value" compartment could also be short-lived as stabilising rates start reviving interest for hot stocks. Furthermore, SPACs promoters can always adjust to the prevailing investment trends in terms of sector popularity. Should it become fashionable to IPO a restaurant chain or a hospitality concept again, it is likely that a new dedicated structure would enter the market without delay.

IPOX SPAC Index YTD Performance vs. SPX & NDX



Sources: Bloomberg, Natixis

In our view, the SPAC mania is unsustainable for 2 reasons:

First, major **conflicts of interest** exist between the various types of SPAC investors. Because the search period is limited to 2 years, and because the Sponsor's initial commitment is at risk, there is a strong incentive to propose a merger even if the target is of a low quality. It has also become increasingly common for SPACs to acquire businesses in which one of the sponsors or one of their strategic partners already owns a private stake, allowing themselves to generate P&L on both sides of the equation. Some will argue that a bad deal can always be rejected at the shareholders' meeting, but this presupposes that all shareholders have the same level of information and a clear understanding of the acquisition terms. They rarely do. For example, side payments are regularly made to inside investors in the form of shares or warrants in exchange for their commitment not to redeem their shares. Conversely, hedge fund participants may vote in favour of the deal but elect to redeem and keep only the warrant exposure, leaving the long-only and retail crowds to bear the risk of the new combined operations on their own.

So far, the SEC has only issued guidance to remedy those issues. On December the 22nd, 2020, it published its CF Disclosure Guidance: Topic No 11, detailing its views on the matter.

> *"A SPAC preparing to conduct an IPO or present a business combination transaction to shareholders should consider carefully its disclosure obligations under the federal securities laws as they relate to conflicts of interest, potentially differing economic interests of the SPAC sponsors, directors, officers and affiliates and the interests of other shareholders and other compensation-related matters."*

SEC, Division of Corporation Finance, CF Disclosure Guidance: Topic No. 11

The note identifies several areas where clear and appropriate disclosure may soon become necessary, including the full description of the sponsors' incentives and securities ownership, the level of control that they, together with their partners, would have over approval of a business combination, and the strength of their track record regarding previous SPAC offerings. Similarly, details of any related private placement - including side-payments made to investors – the nature of the fees paid to underwriters, and whether additional debt financing would be required to close a transaction, may have to be explained. Finally, the rationale behind the target selection – including the existence of any interest the sponsors may have had in it, may have to be clarified.

It will be interesting to monitor the level of compliance with Note No 11 over the coming months: for now, we doubt very much that SPACs will rush to adopt the proposed level of transparency and more stringent legislation may have to be implemented in the future in order to reach that goal.

The second reason behind our SPAC scepticism is that the post-merger performance of the listed companies is often very negatively impacted by the **dilution** resulting from the SPAC's structure and its mechanisms:

- As discussed previously, the sponsors typically receive a "free" 20% Class B promote after the IPO. After negotiation with PIPE investors, these securities are sometimes partially transferred or abandoned, but they remain an important source of dilution.
- The systematic allocation of warrants to Class A shareholders also results in dilution, the amount of which depends on the warrants' parity (2/1, 3/1 or 4/1 in most cases), the timing of the merger (warrants become exercisable at the later of 12 months after the closing of the SPAC IPO and 30 days after the merger is consumed), and the post-merger spot direction (exercise price is generally set at $11.5 with a recall option around $18). Note that although Class A shares can be redeemed by SPAC shareholders, the number of outstanding warrants does not change.
- The sponsors will be looking to replace any redeemed capital by fresh equity from PIPE investors, which may result in generous discounts being granted in the form of additional warrants.
- Finally, underwriters may occasionally be issued new shares in compensation for their services.

Sadly, it is very difficult for a long-term investor who wishes to support a SPAC deal based on its fundamentals to make an accurate assessment of the total level of dilution that he will be facing after the merger.

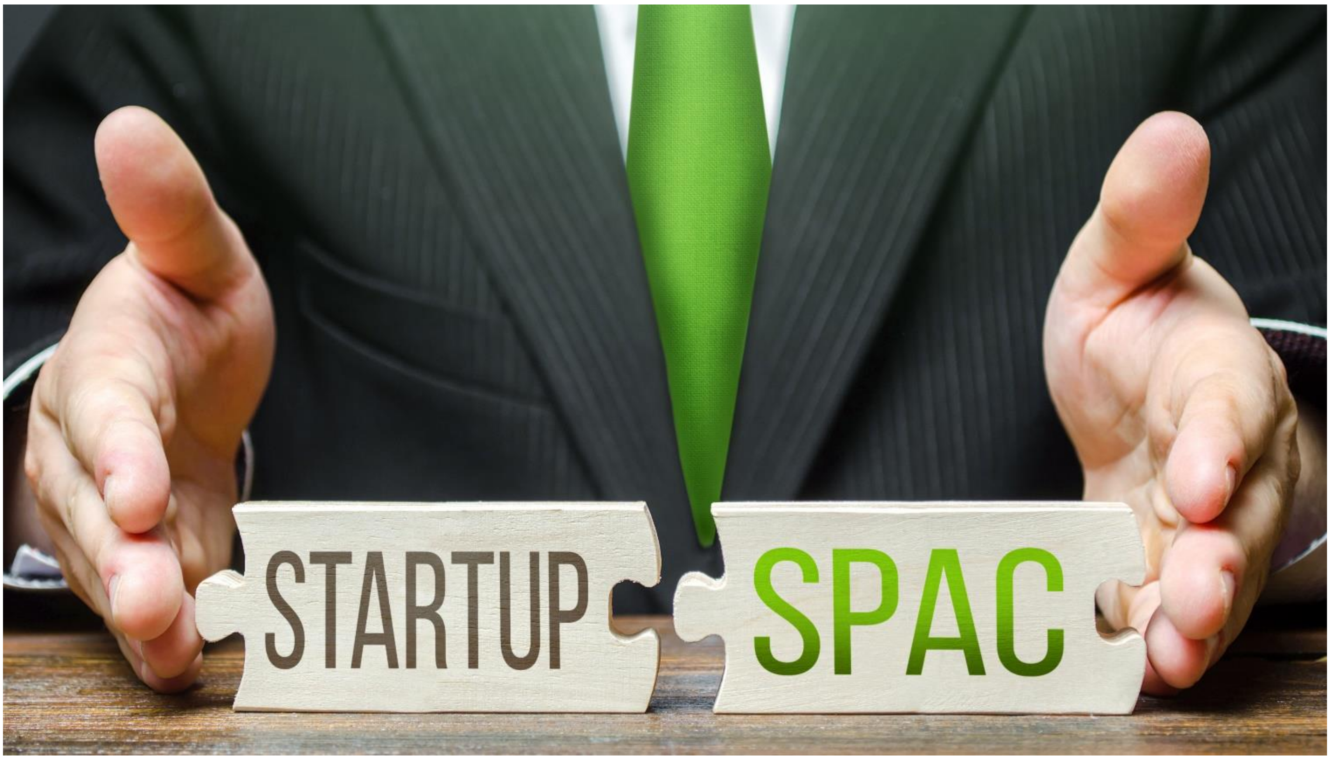
- By targeting larger acquisitions, sponsors are hoping to reduce the dilutive impact of the Class B shares and warrants. As a result, it is estimated that they normally pursue companies with Enterprise Value in the range of 2x to 4x times the IPO proceeds.
- Klausner, Ohlrogee and Ruan estimate that the median post-merger dilution cost for their 2019-2020 SPAC universe is 14.1%, with the 75th percentile at 21% (*a Sober Look at SPACs, April 2021*). Long term investors holding the stocks through the merger therefore have to strongly believe that future value creation will compensate for that loss.

Looking at the post-merger stock performance of 90 de-SPAC transactions in 2020-2021, it is clear that a lot of dispersion is happening. However, a few very successful transactions (Betterware de Mexico, Draftking, MP Materials, Quantumscape…) can't hide the fact that the median performance is generally negative, whether looking at 1 month (-12%), 3 month (-4.5%), 6 month (-16%) or taking the whole observation period into account (-7.5%). The below table summarises our findings:

Post merger Performance	Nb of companies	Average	Median	Min	Max	25th percentile	75th percentile
Post merger to date	90	5.84%	-7.43%	-88.84%	317.91%	-30.80%	6.79%
20d post-merger	90	0.43%	-11.98%	-68.70%	210.19%	-17.80%	16.82%
60d post-merger	69	2.73%	-4.46%	-69.68%	147.12%	-26.14%	30.19%
120d post-merger	32	6.73%	-16.17%	-83.54%	191.67%	-34.41%	36.60%

Sources: Natixis, Bloomberg, sample of 90 US de-SPAC transactions from Jan 1st 2020 to April 8th 2021

Although, on a case by case basis, there can be many reasons why the performance of those stocks remains disappointing even after a year (office developer Ucommune may not have been helped by the rise of the Work-From-Home trend), we can safely assume that excessive dilution is always one of them.



Will the craze spread to Europe?

So far, the SPAC phenomenon has been very concentrated in America with over 98% of all IPO proceeds raised in New York. However, the constant search for quality assets – and arguably, the increasing saturation of the American market – could now be forcing sponsors to look for new targets abroad.

Over recent months, several European companies have already chosen to merge with a US SPAC and many prominent vehicles listed on the NYSE or the Nasdaq are specifically looking for a European target.

Recent US SPACs looking for European opportunities

IPO Date	SPAC Name	Listing	IPO Size ($mn)	Sponsor	Strategy	Identified Target	EV ($mn)	Status
avr-21	Tio Tech A	NASDAQ	300	Dominik Richter, Roman Kirsch	FinTech, consumer tech, SaaS or media company	-	-	Searching
mars-21	Rocket Internet Growth opportunities	NYSE	250	Olivier Samwer, Soheil Mirpour	Tech	-	-	Searching
mars-21	European Biotech Acquisition Corp	NASDAQ	120	Kleijwegt, Eduardo Bravo	Life sciences	-	-	Searching
mars-21	Aurora acquisition Corp	NASDAQ	220	Björgólfsson, Massenet, Narasimhan	TMT	-	-	Searching
févr-21	Kismet Acqusition Two Corp	NASDAQ	200	Ivan Tavrin	Tech	-	-	Searching
janv-21	European Sustainable Growth Acquisition Corp	NASDAQ	125	Lucerne Capital Management	Sustainable Tech	-	-	Searching
janv-21	Constellation Acquisition Corp I	NYSE	300	Kleinfeld, Weckwerth and Stapp	ESG	-	-	Searching
janv-21	North Atlantic Acquisition Corp	NASDAQ	380	Andrew Morgan, Gary Quin	Consumer, industrials, TMT	-	-	Searching
nov-20	Investindustrial Acquisition Corp	NYSE	350	Roberto Ardagna, Andrea Cicero, Sergio Ermotti	Healthcare, Tech, Consumer	-	-	Searching
oct-20	TPG Pace Beneficial Finance Corp	NYSE	350	TPG Pace Beneficial Finance	Smart charging for EVs	EVBox (2010, Netherland)	969	Announced December 2020, expected to close in Q1 2021
oct-20	Avanti Acquisition Corp	NYSE	600	NSS Group and Sienna Capital	Various Industries	-	-	Searching
sept-20	Broadstone Acquisition Corp	NYSE	300	Hugh Osmond, Marc Jonas, Edward Hawkes	Fondamentally sound business in Europe that may be stressed due to the pandemic	-	-	Searching
août-20	Gores Holdings V Inc	NASDAQ	525	Alec Gores, Mark Stone, Andrew McBride	Metal packaging	Ardagh group SA (2011, Luxembourg)	8500	Announced February 2021 , expected to close in Q2 2021
août-20	dMY Technology group INC II	NYSE	275	Niccolo de Masi, Harry L. You	Sports, Betting, Media	Genius Sports Group (2016, UK)	1500	Announced October 2021, expected to close in April 2021
août-20	Kismet Acquisition One Corp	NASDAQ	250	Ivan tavrin	Gaming	Nexters (2010, Cyprus)	1900	Announced February 2021 , expected to close in Q2 2021
août-20	Foley Trasimene Acqusition Corporation II	NYSE	1500	Willian P. Foley	Digital Payments	Paysafe (1996, UK)	9000	Announced in December 2020 Closed March 30th 2021
nov-19	Alussa Energy Acquisition Corporation	NYSE	290	Daniel L. Barcelo	Batteries	FREYR (2018, Norway)	529	Announced in January 2021, expected to close in Q2 2021
nov-19	CIIG Merger Corporation	NASDAQ	260	Peter Cuneo, Gavin Cuneo, Michael Minnick	Electric Vehicles	Arrival (2015, UK)	5400	Announced in November 2020, Closed March 24th 2021

Sources: Natixis, SPAC websites and Press Releases

This new trend will inevitably provoke a strong reaction from European political circles and accelerate the adoption of SPAC structures on the old continent. In the UK for example, the Listing Review prepared by Lord Hill and published in March 2021 states that “the recent use by a number of technology-focused companies of the de-SPAC route in the US indicates a risk that the UK is losing out on home-grown and strategically significant companies coming to market in London”.

There are also additional difficulties for European businesses wishing to merge with a US acquirer: failure to meet the SEC Foreign Private Issuer (FPI) criteria translates into higher accounting and compliance costs as US GAAP standards have to be adopted. From an audit perspective, the financial statements that are required to complete the merger also have to be in line with the Private Company Accounting Oversight Board (PCAOB) standards, which adds another layer of complexity.

It may therefore be a lot easier to merge with a European vehicle instead. Nevertheless, the actual number of European SPAC IPOs remains small.

After surpassing London as Europe’s largest share trading hub in January, Amsterdam is positioning itself as the new hotspot for SPAC listings in the region. Even so, Dutch Star Company TWO (€110mn), EFIC1 (€415mn) and ESG Core Investments (€250mn) are the only active vehicles on our radar. Granted, new projects by Bernard Arnault, Jean-Pierre Mustier and Tikehau (Pegasus, €250mn) or tech entrepreneur Michael Tobin (Crystal Peak, €200-300mn) will soon add to the list, but we are still far from the volumes observed on the other side of the Atlantic.

Elsewhere, Frankfurt recorded its first SPAC listing in February (Lakestar SPAC 1 SE, €275mn, backed by Venture Capitalist Klaus Hommels), so did Stockholm in March (ACQ Bure, €345mn) and Paris announced 2MX in December ran by Xavier Niel, Matthieu Pigasse and Moez-Alexandre Zouari (€300mn).

Recent European SPAC listings over €100mn

IPO Date	SPAC Name	Listing	Size (€mn)	Sponsors	Strategy
Pending	360 Disruptech EU	Paris	250	360 Capital Partners	Tech
Pending	Crystal Peak	Amsterdam	250	Michael Tobin	Tech
Pending	Pegasus	Amsterdam	250	Bernard Arnault, Jean-Pierre Mustier, Tikehau Capital	Fintech
26-mars-21	EFIC1	Amsterdam	415	Martin Blessing, Ben Davey, Nick Aperghis and Klaas Meertens	Fintech
25-mars-21	ACQ Bure AB	Stockholm	345	Bure Equity AB	Nordic ESG
22-févr-21	Lakestar SPAC 1 SE	Frankfurt	275	Klaus Hommels	Tech
12-févr-21	ESG Core Investment	Amsterdam	250	Infestos	ESG
07-déc-20	2MX	Paris	300	Niel, Pigasse, Zouari	Sustainable Consumer goods & distribution
19-nov-20	Dutch Star Company TWO	Amsterdam	110	Nick Hoek, Stephan Nanninga, Gerbrand ter Brugge	Agriculture, Logistics, Industry, Tech in the Netherlands

Sources: Natixis, Euronext, Deutsche Boerse, Nasdaq Stockholm, Press Releases

Volumes will increase as a result of more countries seeking to adapt, optimise or strengthen their SPAC legal framework. We find for example that SPACs in Amsterdam and Frankfurt already present very similar features to their US cousins whilst the UK is more distant in terms of rules and is working to catch up with the latest trends.

Below are some of the main structural SPAC differences between the countries mentioned above, based on our analysis of a recent note published by Freshfields (*US SPAC Boom Spreads to Europe with Recent Amsterdam and Frankfurt SPAC Listings and Potential Reform in London, March 2021*):

- **Shareholder promote:** In NY, Amsterdam and Frankfurt, Class B founder shares give access to 20% of the SPAC’s equity at the closing of the transaction. Their nominal price varies from $25,000 in the US to €136,000 in Germany. In the UK, sponsors also hold Class C shares that pay a dividend based on the SPAC’s market performance. Sponsor lock-up is normally 1Y in the US and Frankfurt (subject to early release depending on market performance), and can be shorter in the Netherlands (6 months).

- **Warrants:** in NY, Frankfurt and London, all warrants are issued as part of the units distributed during the SPAC's IPO. In Amsterdam, and although Dutch law can be flexible, 50% of the warrants are issued to IPO Shareholders if and when the business combination has been consumed. Exercise price is generally 11.5 in local currency but can vary between €9.0 and €13.0 in Amsterdam. Maturity is typically 5Y, except in the UK where it is 3Y. In the US, warrants can be redeemed by the company above $18, whilst in Europe, the threshold varies between €10 and €18.
- **Minimum Size:** In the US, targets must have a market value equal to at least 80% of the value of the assets held by the SPAC. In Europe, no such restriction exists giving sponsors more flexibility in terms of deal size (for example, multiple smaller acquisitions are possible).
- **Shareholder Approval:** a 50% majority is required in NY and Frankfurt to validate the business combination. Recent Amsterdam structures have demanded a 70% majority although there is flexibility for lower thresholds. In the UK, shareholder approval is not required.
- **Shareholder Redemptions:** in NY and Frankfurt, shareholders have the right to redeem their shares and keep their warrants at the time of the business combination, irrespective of their participation or how they choose to vote. In Amsterdam, the law is flexible but recent SPACs have only offered the right to redeem to shareholders voting against the combination, when the business combination is otherwise approved by the Assembly. In the UK, there are no redemption rights, and SPAC shares are suspended after the announcement of a merger deal. This has often been seen as a major obstacle to the development of SPACs in the country and the March 2021 UK Listing Review of Lord Hill argues in favour of bringing the UK in line with international practices from that respect.
- **Forward Looking Statements**: US SPAC transactions benefit from a safe harbour exemption allowing targets to reference forward looking statements. In Amsterdam and Frankfurt, no established market practice has emerged yet and projections are subject to regulatory review if a prospectus is needed. In the UK, the FCA requires such prospectus and restrictions apply (another point of concern in the March 2021 UK Listing Review).

Of course, the success of European SPACs may eventually be capped by the fact that European IPO processes tend to be less complex and less constraining than in the US, making the SPAC route less appealing to entrepreneurs overall. Swedish Fintech Klarna's CEO Sebastian Siemiatkowski told Reuters in March that "no one had yet convinced him about why that would be a preferential route". From our conversations with ECM professionals, we also gather that European institutional investors are perhaps more conservative than their US counterparts and may not want to entertain highly speculative growth investments based on sometimes exuberant forward-looking projections. Finally, European retail investors are simply less active and may require more training and education before joining a SPAC offering.

The SPAC Mania may therefore take more time to spread in the region and it will probably never reach the intensity observed in America. We also believe that, coming slightly late to the party and being aware of standard US SPACs drawbacks, European investors will likely demand a better deal before getting involved.

Will SPACs long-term investors start getting a better deal?

This is quite likely in our view.

The proliferation of SPACs structures in the US is shifting the balance of power between sponsors and targets. Innovative start-up businesses get approached by many different teams and can likely organise beauty contests in order to receive the best possible treatment at the lowest cost to them and their long-term investors.

New types of structures are also emerging that, in theory, are more aligned with investors' interests. Bill Ackman's Pershing Square Tontine vehicle is possibly one of them. It raised $4bn through its IPO in July 2020 and is expected to raise another $1bn to $3bn in the form of units comprised of a class A share and a warrant equivalent to 1/3 of a class A share thanks to a forward purchase agreement entered with Pershing Square. According to its prospectus, the SPAC intends to acquire a minority interest in a large capitalisation high quality growth company, which will probably make for a very high-profile transaction if such target can be identified before the 2-year deadline.

The most striking feature of the PS Tontine vehicle is that the sponsors are not taking advantage of the usual 20% promote. They are instead purchasing warrants at market value for a maximum of 5.95% of the post-merger equity and can only exercise them after 3 years, if the stock is up by a minimum of 20%. The sponsors also hold 100 class B shares giving them 20% of the voting power immediately after the IPO.

Investors in the IPO receive a class A share and a warrant equivalent to 1/9th of a class A share. Those who choose not to redeem their shares prior to the merger are then issued "tontine" warrants equivalent to 2/9th of a class A share. Furthermore, the "tontine" warrants abandoned by redeeming shareholders are redistributed to the shareholders who do not redeem their shares, giving everyone a further incentive to hold the stocks through the combination phase.

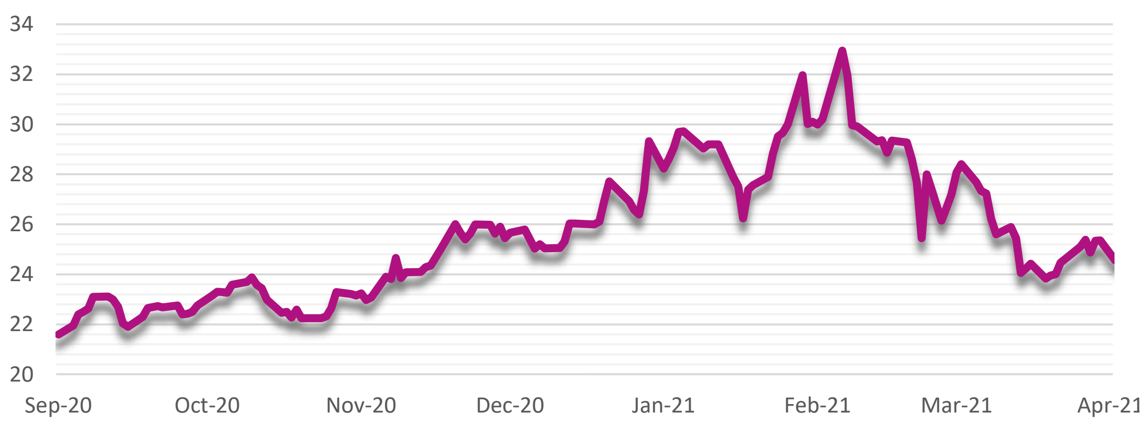
"*We believe that this incentive structure is better aligned with our stockholders and potential merger partners, substantially less dilutive than typical incentive arrangements in other blank check companies, and therefore will be more attractive to potential investors in this offering*"

Pershing Square Tontine Holdings, Ltd, S-1 form, July 13th, 2020

The Pershing Square Tontine Class A shares started trading on the NYSE in September 2020 and reached a high of 32.95 in February 2021 before dropping back to 24.7 in April. Despite their recent underperformance, they continue to trade 23.5% above par in a clear signal that investors are valuing the quality of the sponsor and its ability to generate post-combination value, but also the better alignment of all participants in the transaction.

So far, only a small number of SPACs have deviated from the standard features, but as SPAC fatigue sets in, PIPE injections become more difficult to secure and valuations are more conservative, we can see a future for fairer, less dilutive structures in Europe and elsewhere.

Pershing Square Tontine - Class A Share Performance since IPO



Source: Bloomberg

PS - According to the Oxford dictionary, a tontine is an "annuity shared by subscribers to a loan or common fund, the shares increasing as subscribers die until the last survivor enjoys the whole income". The scheme takes its name from Lorenzo Tonti (1630-95), a Neapolitan banker who developed the strategy to raise government loans in France (c1653).

Conclusion

In our view, SPACs mania is the result of the convergence of extremely accommodative macro-economic conditions in the post-pandemic world and a large number of growth companies ran by entrepreneurs looking to exploit the resulting momentum before it is too late. Although SPAC's ability to provide these businesses with a faster and lighter route to a public listing has been exaggerated, we see major inherent conflicts of interest and excessive dilution as the two main reasons why the euphoria is unlikely to last in its current form. Meanwhile, in Europe, investors are warming up to the concept and regulators are working to adapt their legal framework. However, we can't imagine volumes getting anywhere near those observed in the US over the past 15 months. SPACs will indeed be consumed with more moderation and with a pronounced taste for fairer structures where the interest of sponsors and investors is more closely aligned.

For investors looking to enter the world of SPACs for the first time, it is important to understand the difference between the pre and post-merger phases. Between the IPO and the de-SPAC transaction, it can be very profitable to buy those stocks close to par and sell them on a spike after rumours of an exciting acquisition start to emerge. Portfolio diversification remains essential and the less sophisticated traders may want to place their bets via one of the available SPAC ETFs in the market. Investors looking to hold their shares through the combination phase need to be careful however: they expose themselves to large amounts of dilution and a very intense overhang from warrants' exercises in the years after the deal. A very deep understanding of the operational company, its fundamental drivers and its path to value creation is necessary to avoid bitter disappointment.

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